



COMMONWEALTH OF MASSACHUSETTS
OFFICE OF CONSUMER AFFAIRS AND BUSINESS REGULATION
DIVISION OF INSURANCE

REPORT OF EXAMINATION OF

Health New England, Inc.

Springfield, Massachusetts

As of December 31, 2012

NAIC GROUP CODE 04756

NAIC COMPANY CODE 95673

EMPLOYER ID NUMBER 04-2864973

Health New England, Inc.

TABLE OF CONTENTS

	<u>Page</u>
Salutation	1
Scope of Examination	2
Summary of Significant Findings	3
Subsequent Events	3
Company History	3
General	3
Corporate Records	4
Board of Directors Minutes	4
Articles of Incorporation and Bylaws	4
Conflict of Interest Procedures	4
Disaster Recovery and Business Continuity	5
Management and Control	5
Board of Directors	5
Committees of the Board of Directors	6
Officers	6
Affiliated Companies	7
Organization Chart	8
Transactions and Agreements with Subsidiaries and Affiliates	8
Fidelity Bonds and Other Insurance	9
Pensions, Stock ownership and Insurance Plans	9
Territory and Plan of Operation	9
Growth of Company	9
Reinsurance	10
Ceded Reinsurance	10
Accounts and Records	10
Statutory Deposits	11
Financial Statements	12
Statement of Assets, Liabilities, Capital and Surplus	13
Statement of Revenue, Expenses and Capital and Surplus	14
Reconciliation of Capital and Surplus	15
Comments on Financial Statements Items	16
Summary of Recommendations	17
Acknowledgement	18



COMMONWEALTH OF MASSACHUSETTS
Office of Consumer Affairs and Business Regulation
DIVISION OF INSURANCE

1000 Washington Street, Suite 810 • Boston, MA 02118-6200
(617) 521-7794 • Toll-free (877) 563-4467
<http://www.mass.gov/doi>

DEVAL L. PATRICK
GOVERNOR

GREGORY BIALECKI
SECRETARY OF HOUSING AND
ECONOMIC DEVELOPMENT

BARBARA ANTHONY
UNDERSECRETARY OF CONSUMER AFFAIRS
AND BUSINESS REGULATION

JOSEPH G. MURPHY
COMMISSIONER OF INSURANCE

May 28, 2014

Honorable Joseph G. Murphy
Commissioner of Insurance
Commonwealth of Massachusetts
Division of Insurance
1000 Washington Street, Suite 810
Boston, MA 02118-6200

Honorable Commissioner:

Pursuant to your instructions and in accordance with Massachusetts General Laws ("M.G.L."), Chapter 176G, Section 10, an examination has been made of the financial condition and affairs of

HEALTH NEW ENGLAND, INC.

at its home office located at One Monarch Place, Springfield, MA 01144. The following report thereon is respectfully submitted.

SCOPE OF EXAMINATION

Health New England, Inc. ("Company" or "HNE") was last examined as of December 31, 2009 by the Massachusetts Division of Insurance (the "Division"). The current examination was also conducted by the Division and covers the three-year period from January 1, 2010 through December 31, 2012, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this examination.

The examination was conducted in accordance with standards and procedures established by the National Association of Insurance Commissioners ("NAIC") Financial Condition (E) Committee and prescribed by the current NAIC *Financial Condition Examiners Handbook*. The Handbook requires that we plan and perform the examination to evaluate the financial condition and identify prospective risks of the Company by obtaining information about the Company, including corporate governance, identifying and assessing inherent risks within the Company, and evaluating system controls and procedures used to mitigate those risks. An examination also includes assessing the principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation, management's compliance with Statutory Accounting Principles and annual statement instructions, when applicable to domestic state regulations. All accounts and activities of the Company were considered in accordance with the risk-focused examination process.

In addition to a review of the financial condition of the Company, the examination included a review of the Company's business policies and practices, corporate records, reinsurance treaties, conflict of interest disclosure statements, fidelity bond and other insurance, employees' benefits plans, disaster recovery plan, treatment of policyholders and other pertinent matters to provide reasonable assurance that the Company was in compliance with applicable laws, rules and regulations. In planning and conducting the examination, consideration was given to the concepts of materiality and risk and examination efforts were directed accordingly.

The Company is audited annually by Ernst and Young LLP ("E&Y"), an independent Certified Public Accounting firm. The firm expressed unqualified opinions on the Company's financial statements for the calendar years 2010 through 2012. A review and use of the Certified Public Accountants' work papers were made to the extent deemed appropriate and effective. KPMG LLP ("KPMG") was engaged to perform certain agreed-upon procedures, which are in compliance with the NAIC *Financial Condition Examiners' Handbook*. KPMG's Health Actuaries were involved in the performance of those procedures to the extent that such procedures related to the Company's reserves for unpaid claims and loss adjustment expenses and provider risk sharing settlements as of December 31, 2012. KPMG's Information Technology Advisory Services personnel were engaged to perform an Evaluation of Controls in Information Systems Questionnaire in a form substantially similar to the one established in the NAIC *Financial Condition Examiners' Handbook*. All procedures were performed under the management and control and general supervision of the examination staff of the Division.

SUMMARY OF SIGNIFICANT FINDINGS

For a summary of findings contained within this report, refer to the “Summary of Recommendations” section on page 17. The previous report of examination noted the Company’s non compliance with certain bylaws as they relate to the required number of Baystate Health and Physician directors. During the current exam we note the Company was in compliance with these bylaws.

SUBSEQUENT EVENTS

During 2012, the Company petitioned the Internal Revenue Service (“IRS”) to be recognized as a tax exempt entity under Section 501 (C) 4 of the Internal Revenue Code (“IRC”) based on its conversion to a nonprofit corporation. Effective 1/1/13, the Company began operating under the premise that this tax exempt status has been granted by the IRS.

During 2012, the Company formed a new subsidiary insurance company licensed pursuant to M.G.L. Chapter 156B and pursuant to Chapter 175, Section 47. This entity commenced business January 1, 2013 offering a Medicare Supplement product.

During 2013, the Company began serving as the third party administrator for Minuteman Health. Minuteman Health is a non-profit federally funded health plan designated as a Consumer Operated and Oriented Plan (CO-OP) under the Affordable Care Act.

During 2014, the Company began the process of acquiring licensed status in the State of Connecticut of its subsidiary, Health New England of Connecticut, Inc, to offer a Medicare Advantage product in the State of Connecticut. Effective May 6, 2014 the State of Connecticut granted Health New England of Connecticut licensed status.

COMPANY HISTORY

General

HNE is a Health Maintenance Organization (“HMO”) domiciled in Massachusetts. HNE was incorporated as a Massachusetts corporation on May 17, 1985. The Company was licensed as an HMO by the Massachusetts Commissioner of Insurance (the “Commissioner”) on November 27, 1985 and commenced business on January 1, 1986. The Company was granted Federal Qualification as an HMO by the U.S. Department of Health and Human Services on June 1, 1987.

The Company was formed by capital contributions from three hospitals including Baystate Health, Inc. (“BH”) the parent corporation of Baystate Medical Center, and a group of BH-affiliated private care physicians. In March 1997, the Company underwent a corporate reorganization, issuing approximately \$1.5 million in notes payable to former physicians and hospital shareholders; BH ownership increased to an approximate 95% interest. In July 1998, the

Health New England, Inc.

Company and Harvard Pilgrim Health Care, Inc. ("HPHC") executed a stock purchase agreement, whereby the Company issued additional common stock in exchange for HPHC's business in Western Massachusetts. BH subsequently entered into an agreement with HPHC, whereby HPHC purchased a portion of BH's interest in HNE.

HPHC entered receivership in January 2000 and the Commissioner assumed direct supervision and control of HPHC's assets and operations. In February 2000, BH submitted a proposal to purchase HPHC's ownership interest in HNE. BH completed this purchase in October 2000, gained 95.8% of the Company's shares with affiliated physicians controlling the remaining 4.2%. The Company subsequently reached a settlement agreement with the physician and hospital shareholders in connection with notes issued to them in March 1997. The majority of those note holders executed settlement of the notes under the terms of the agreement.

As of December 31, 2012, BH owns a 99.52% interest in the Company, with network physicians controlling the remaining 0.48% interest.

On December 20, 2012, HNE's shareholders voted to convert HNE from a for-profit stock corporation to not-for-profit entity with the sole owner becoming Baystate Health, effective January 1, 2013.

CORPORATE RECORDS

Board of Directors Minutes

The minutes of meetings of the Board of Directors ("Board") and its Committees for the period under examination were read and they indicated that all meetings were held in accordance with the Company's bylaws and the laws of the Commonwealth of Massachusetts. Activities of the Committees were ratified at meetings of the Board.

Articles of Incorporation and Bylaws

The Articles of Incorporation ("Articles") of the Company approved on June 12, 1997. The bylaws of the Company approved on June 11, 1997 were amended on April 13, 2010 to reflect clerical changes within the document. The Articles and the bylaws were read and reviewed.

Conflict of Interest Procedures

The Company has adopted a policy statement pertaining to conflict of interest in accordance with Question 18 of the General Interrogatories of the Annual Statement. The Company has an established procedure for the disclosure to the Board of any material interest or affiliation on the part of any officer, director, or "Covered Person" which is in or is likely to conflict with his/her official duties. "Covered Persons" are defined as members of the Board of Directors of HNE, HNE's corporate officers, as named by the HNE bylaws or by the Board, and also covers any employees of HNE designated from time to time by the HNE Board or by HNE's President and Chief Executive Officer, each of whom will be notified that he or she is a Covered Person.

Health New England, Inc.

A Covered Person must disclose the existence of any potential conflict of interest (e.g., a financial or competitive interest or other obligation to another entity) and all material facts to the Company's Board, or to any committee or individual designated by the Board to receive such disclosures. Each Covered Person shall annually receive a copy of the Company's conflict of interest policy, and shall be asked to report any potential conflicts to the Board or its designee at least annually on a form prescribed by the Board. Each Covered Person shall be required to report any material changes to the information in the report to the Board or its designee as soon as such changes occur.

The completed conflict of interest statements were reviewed, and no discrepancies were noted in the response to the General Interrogatories regarding conflicts of interest as reflected in the Company's 2012 Annual Statement.

Disaster Recovery and Business Continuity

The Company provides for the continuity of management and operations in the event of a catastrophe or national emergency in accordance with M.G.L., Chapter 175, Sections 180M-180Q.

MANAGEMENT AND CONTROL

Board of Directors

According to the by-laws, the Company's business and affairs shall be managed by a Board of Directors, who may exercise all the powers of the Corporation except as otherwise provided by law, the Article of Organization or the bylaws. The Board shall consist of up to sixteen (16) Directors, consisting of two directors serving ex officio and up to fourteen (14) Directors elected by the Member at the annual meeting of the Member or at a special meeting called for the purpose. The directors serving ex officio shall be: the Chief Executive Officer of BH and the President/Chief Executive Officer of the Company. The Chair of the Board or his designee shall serve as a voting member of the Board, and the President/Chief Executive Officer shall be a non-voting member of the Board. Each director (other than the ex officio Directors) shall hold office until the next annual meeting of the Member or until his or her successor shall have been duly elected and qualified, unless he or she sooner dies, resigns, is removed, or becomes disqualified. There shall be no limit to the number of consecutive terms an individual may serve as a Director.

Directors elected and serving at December 31, 2012, with business affiliations and Director class are as follows:

<u>Name of Director</u>	<u>Principal Occupation</u>	<u>Director Class</u>
Bruce Brown	Retired President Monarch Life Insurance Company	BH Director
Dennis Chalke	Sr. VP Finance, CFO and Treasurer Baystate Health, Inc.	BH Director

Health New England, Inc.

Joel Feinman, PhD	President, Valley Medical Group Greenfield Health Center	BH Director
Eric Fuller, III	Retired President Holyoke Card & Paper	BH Director
Mary Ellen Scott	President, United Personnel	BH Director
Peter Straley	President & Chief Executive Officer Health New England	Ex officio Director
Mark Tolosky	President & Chief Executive Officer Baystate Health, Inc.	Ex officio Director
Benjamin Liptzin, MD	Chair Dept. of Psychiatry/BMERF Baystate Health, Inc.	Physician Director
Robert Lounsbury, MD	President Riverbend Medical Group	Physician Director
Richard Segool, MD	Pioneer Valley Pediatrics Private Practicing Pediatrician	Physician Director
Stephen Sweet, MD	President & Chief Executive Officer Baycare Health Partners	Physician Director
Steven Wenner, MD	New England Orthopedic Surgeons Private Practicing Orthopedic Surgeon	Physician Director

Committees of the Board of Directors

The bylaws state that the Board of Directors may appoint such committees of the Board as are deemed necessary. Board committees may be temporary or continuing, shall act under the supervision of the Board, and shall act with respect to such special or general matters as the Board may from time to time determine. All or any such committee or committees may be terminated at any time by the Board.

The standing committees of the Board of Directors shall consist of an Executive Committee. In addition to the Executive Committee, the standing committees of the Board include a Compensation Committee, Finance Committee, Nominating Committee and a Quality Committee.

Officers

The Company's officers shall consist of a President, a Treasurer, a Secretary and such other officers as the Board of Directors may determine. The President, Treasurer and Secretary shall be elected by the Board at any meeting thereof. Other officers shall be elected by the Board or by the Executive Committee. The President may, but need not, be a director. No officer need be a shareholder. Any two or more offices may be held by the same person.

Officers of the Company at December 31, 2012, in addition to those directors above are as follows:

Health New England, Inc.

<u>Name of Officer</u>	<u>Title</u>
Peter Straley ¹	President and CEO
Robert Kosior	Vice President, Finance and CFO
Mark Tolosky	Chairman
Judith Danek	Secretary and Clerk
Richard Segool MD	Vice Chairman
Dennis Chalke	Treasurer
Thomas Ebert MD	Vice President, Chief Medical Officer
James Kessler ESQ	Vice President & General Counsel
Phillip LaCombe	Vice President, Information Technology
Juan Campbell	Vice President, Sales
Amy Trombley	Vice President & Chief Talent Officer
Noel Blagg MD	Associate Medical Director
Renee Wroth ESQ	Compliance Officer & Privacy Officer
David Methe	Security Officer
Maura McCaffrey ¹	Chief Operating Officer

¹ – Peter F. Straley stepped down as a member of the Executive and Finance committees and as the President and CEO on April 4, 2014. All three positions were subsequently filled by Maura McCaffrey.

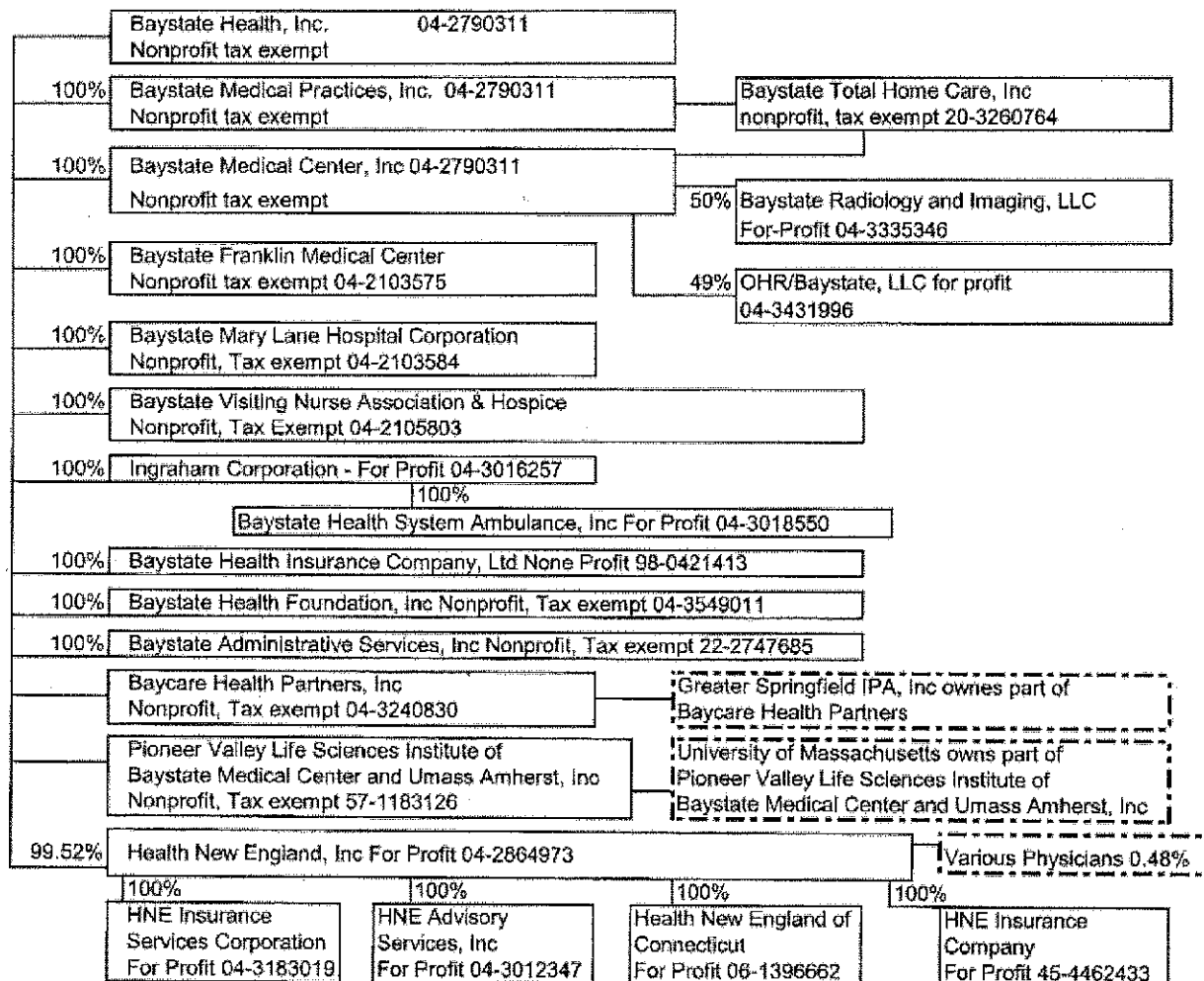
Affiliated Companies

The Company is a member of a holding company system and subject to the registration requirements of Section 28 of M.G.L. Chapter 176G and Section 206C of M.G.L. Chapter 175 and Regulation 211 CMR 7.00. BH is the “ultimate controlling person” for the Company.

Health New England, Inc.

Organization Chart

A summary of ownership and relationship of the Company and its operating subsidiaries and affiliated companies as of December 31, 2012 is illustrated below:



Transactions and Agreements with Subsidiaries and Affiliates

Administrative and Intercompany Services Agreements

The Company has in place administrative and intercompany agreements with its subsidiaries to provide services supporting the operations of these companies. The Company also has an agreement with its parent, BH. The Company has transactions in the normal course of business with BH primarily for medical claims expense for services provided to HNE members by BH and BH subsidiaries. Administrative fees are exchanged between the Company and its parent and subsidiaries for the various services provided.

Tax Sharing Agreement

The Company's Federal Income Tax Return is filed on a consolidated basis with its subsidiaries and subject to a tax sharing agreement.

FIDELITY BONDS AND OTHER INSURANCE

The Company maintains fidelity coverage with an authorized Massachusetts insurer, consistent with M.G.L., Chapter 175, Section 60. The aggregate limit of liability exceeds the NAIC suggested minimum.

The Company has further protected its interest and property by policies of insurance covering other insurable risks. Coverage is provided by insurers licensed in the Commonwealth of Massachusetts, and the policies were in force as of December 31, 2012.

PENSIONS, STOCK OWNERSHIP AND INSURANCE PLANS

Defined Contribution Plan

HNE provides a 401 (k) Retirement Plan ("Plan") to its employees. Employees may contribute up to 75% of pre-tax annual compensation, as defined in the Plan document. In 2012, 2011, and 2010, HNE matched 100% of the first 6% of employee contributions to the Plan. An additional profit sharing contribution may be made by HNE at its discretion. Contributions and compensation levels are subject to certain limitations under the Internal Revenue Code. All administrative costs associated with the Plan are the responsibility of HNE.

TERRITORY AND PLAN OF OPERATION

The Company is headquartered in Springfield, MA and is licensed to transact business solely in the Commonwealth in Massachusetts. As of December 31, 2012 HNE's service area in Massachusetts included, Hampden, Hampshire, Berkshire, and Franklin and parts of Worcester County.

HNE offers a variety of plans, including health maintenance organization (HMO), point-of-service (POS) and preferred provider organization (PPO) plans. The company also offers a direct Medicare Supplement Insurance product.

GROWTH OF COMPANY

The growth of the Company for the years 2010 through 2012 is shown in the following schedule, which was prepared from the Company's annual statements.

	Admitted			Net
<u>Year</u>	<u>Assets</u>	<u>Liabilities</u>	<u>Surplus</u>	<u>Premium</u>
				<u>Income</u>
2012	\$127,635,924	\$77,367,530	\$50,268,394	\$494,219,233
2011	133,559,111	79,903,292	53,655,819	460,630,229
2010	102,246,992	55,464,655	46,782,337	392,349,927

REINSURANCE

Ceded Reinsurance

HNE has reinsured its liability for certain catastrophic medical services. The reinsurance contract provided for coverage of any HMO member's cumulative inpatient and outpatient hospital facility claims in excess of \$500,000 per member in 2012, subject to certain limitations as defined in the contract.

ACCOUNTS AND RECORDS

The internal control structure was discussed with management through questionnaires, interviews and through a review of the work performed by the Company's Independent Certified Public Accountants. Testing of key underwriting and claim internal controls was performed. No material deficiencies were noted.

The NAIC provides a questionnaire covering the evaluation of the controls in the IT systems environment. The questionnaire was completed by the Company and reviewed by the examination team to evaluate the adequacy of the IT controls. In addition to the questionnaire, interviews with Company staff were conducted to gather supplemental information and corroborate the Company's responses to the questionnaire. A review was also made of the documentation supporting Management and Organization Controls, Application Systems Development and Maintenance Controls, Operating and Processing Controls, Logical and Physical Security Controls, Contingency Planning Controls, Personal Computer, Local Area Network, Wide Area Network and Internet Controls. No material deficiencies were noted.

The Company maintains its accounts and records on an electronic data processing basis. All entries are input to this data processing system, which then generates general ledger and supporting reports as well as other reports common to the insurance industry. No material exceptions were noted.

During the period under examination, the Company's books and records were audited by Ernst & Young, Independent Certified Public Accountants, in accordance with 211 CMR Section 26.00. During 2013, the Company appointed Deloitte & Touche, LLP as its Independent Certified Public Accountants.

Health New England, Inc.

STATUTORY DEPOSITS

The Company's statutory deposits as of December 31, 2012 are as follows:

<u>Jurisdiction</u>	<u>Purpose of Deposit</u>	<u>Book Value</u>	<u>Fair Value</u>
Massachusetts	Held as restricted cash for uncovered medical expenses for the benefit of all policyholders	\$ 429,975	\$ 429,975
Massachusetts	Cash deposit held for the benefit of all policyholders	83,132	83,132
Massachusetts	US Treasury Note held for the benefit of all policyholders	<u>1,202,348</u>	<u>1,243,256</u>
		<u>\$1,715,455</u>	<u>\$1,756,363</u>

FINANCIAL STATEMENTS

The following financial statements are presented on the basis of accounting practices prescribed or permitted by the Division of Insurance and by the NAIC as of December 31, 2012:

Statement of Assets, Liabilities, Capital and Surplus as of December 31, 2012

Statement of Revenue, Expenses, Capital and Surplus Account for the Year Ended December 31, 2012

Reconciliation of Capital and Surplus for Each Year in the Three-Year Period Ended December 31, 2012

Health New England, Inc.

**Statement of Assets, Liabilities, Capital and Surplus
as of December 31, 2012**

	As Reported by the Company	Examination Changes	Per Statutory Examination
Assets			
Bonds	\$81,838,825	\$0	\$81,838,825
Preferred stocks	35,000		35,000
Common stocks	15,976,129		15,976,129
Cash, cash equivalents and short-term investments	14,732,503		14,732,503
Other invested assets	1,898,819		1,898,819
Subtotals, cash and invested assets	114,481,276	0	114,481,276
Investment income due and accrued	452,787		452,787
Premiums and considerations:			
Uncollected premiums and agents' balances in the course of collection	1,205,216		1,205,216
Current federal income tax recoverable	511,179		511,179
Net deferred tax asset	5,835,771		5,835,771
Electronic data processing equipment and software	1,432,873		1,432,873
Receivable from parent, subsidiaries and affiliates	1,351,897		1,351,897
Healthcare and other amounts receivable	2,256,978		2,256,978
Aggregate write-ins for other than invested assets	107,947		107,947
Total Assets	\$127,635,924	0	\$127,635,924
Liabilities, Capital and Surplus			
Claims unpaid	\$42,675,975	0	\$42,675,975
Accrued medical incentive pool and bonus amounts	10,388,675		10,388,675
Unpaid claim adjustment expense	3,854,530		3,854,530
Premiums received in advance	7,812,313		7,812,313
General expenses due or accrued	11,552,163		11,552,163
Amounts due to parent, subsidiaries and affiliates	107,310		107,310
Payable for securities	976,564		976,564
Total liabilities	77,367,530	0	77,367,530
Common capital stock	2,547,277		2,547,277
Gross paid in and contributed surplus	1,073,490		1,073,490
Unassigned funds (surplus)	46,647,627		46,647,627
Total capital and surplus	50,268,394		50,268,394
Total liabilities, capital and surplus	\$127,635,924	\$0	\$127,635,924

Health New England, Inc.

**Statement of Revenue, Expenses, Capital and Suplus
For the Year Ended December 31, 2012**

	As Reported by the Company	Examination Changes	Per Statutory Examination
Member Months	1,195,401		1,195,401
Net premium income	\$494,219,233	\$0	\$494,219,233
Total revenues	494,219,233	0	494,219,233
Hospital and Medical:			
Hospital/medical benefits	302,166,388		302,166,388
Other professional services	4,256,014		4,256,014
Outside referrals	22,982,713		22,982,713
Emergency room and out-of-area	18,386,549		18,386,549
Prescription drugs	72,783,050		72,783,050
Aggregate write-ins for other hospital and medical	12,216,574		12,216,574
Incentive pool, withhold adjustments and bonus amounts	8,204,497		8,204,497
Subtotal	440,995,785	0	440,995,785
Less:			
Net reinsurance recoveries	3,169		3,169
Total hospital and medical	440,992,616	0	440,992,616
Claims adjustment expenses	16,971,393		16,971,393
General administrative expenses	37,091,317		37,091,317
Total underwriting deductions	495,055,326	0	495,055,326
Net underwriting gain (loss)	(836,093)		(836,093)
Net investment income earned	3,076,303		3,076,303
Net realized capital gains (losses)	935,296		935,296
Net investment gains (losses)	4,011,599	0	4,011,599
Net gain or (loss) from agents' or premium balances charged off	(25,410)		(25,410)
Net income or (loss) after capital gains tax and before all other federal income taxes	3,150,096		3,150,096
Federal income taxes incurred	931,127		931,127
Net Income (loss)	\$2,218,969	\$0	\$2,218,969

Capital and Surplus Account

Capital and surplus prior reporting year	\$53,655,819	\$0	\$53,655,819
Net income or (loss)	2,218,969		2,218,969
Change in net unrealized capital gains (losses)	(293,336)		(293,336)
Change in net deferred income tax	(665,071)		(665,071)
Change in nonadmitted assets	(3,197,839)		(3,197,839)
Cumulative effect of changes in accounting principles	854,276		854,276
Changes in capital paid in	(2,304,424)		(2,304,424)
Net change in capital and surplus	(3,387,425)	0	(3,387,425)
Capital and surplus end of reporting year	\$50,268,394	\$0	\$50,268,394

Health New England, Inc.

Reconciliation of Capital and Surplus
For Each Year in the Three-Year Period Ended December 31, 2012

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Capital and surplus prior reporting year	\$53,655,819	\$46,782,337	\$41,659,893
Net income or (loss)	2,218,969	10,095,811	7,342,633
Change in net unrealized capital gains (losses)	(293,336)	(6,871)	418,803
Change in net deferred income tax	(665,071)	960,008	1,701,287
Change in nonadmitted assets	(3,197,839)	(2,075,549)	(2,265,341)
Change in surplus notes	0	(2,000,000)	(2,000,000)
Cumulative effect of changes in accounting principles	854,276	0	0
Changes in capital paid in	(2,304,424)	(99,917)	(74,938)
Net change in capital and surplus	<u>(3,387,425)</u>	<u>6,873,482</u>	<u>5,122,444</u>
Capital and surplus end of reporting year	<u><u>\$50,268,394</u></u>	<u><u>\$53,655,819</u></u>	<u><u>\$46,782,337</u></u>

COMMENTS ON FINANCIAL STATEMENT ITEMS

Note 1 – Summary of Claims Unpaid and Unpaid Claims Adjustment Expenses

The liability for medical claims payable is based upon HNE's estimate of the total reported and underreported claims attributed to services rendered in the current period. Such estimates are based upon a comprehensive accounting of all reported claims as well as an actuarially determined liability, based on past experience, for claims incurred but not reported. The estimate of the claims payable and claim adjustment liability as of year-end has been reviewed by HNE's independent actuary and management believes that the liability for medical claims payable and unpaid claim adjustment expenses are adequate to cover the ultimate cost of claims outstanding and related claim adjustment. However, final claim payments may differ from the liability established. Any resulting adjustments will be reflected in the results for the year during which the adjustments become known.

Capitation for primary care services, the cost and claim settlement expense related to prescription drugs and medical expenses for hospital inpatient services and outpatient specialty care services are recorded in the period in which they are incurred.

Based on an analysis using claim data through September 2013, it appears as though the unpaid claim liability as of December 2012 is sufficient to cover the expected claim liability. The liability is redundant by approximately \$2.6 million when compared to KPMG's select point estimate. See table below. (Note: The amounts highlighted in the table below are based only on those values actuarially determined and do not include other account values reported as "Claims Unpaid" by the Company, which are not actuarially determined. The value of these other liability accounts totaled \$10,121,123, and have been verified by the examination team if deemed material under the risk focus approach.)

Health New England, Inc.					
	KPMG Estimate				
	Low	Selected Point	High	Company Carried	Redundancy/ (Deficiency)
Claims Unpaid	\$29,582,438	\$29,977,252	\$30,699,927	\$32,554,852	\$2,577,600

Note 2 –Federal Income Taxes

Effective January 1, 2013, HNE began operating as a tax exempt entity. The Company completed the required state filings and notifications as well as required corporate bylaw changes. Based on the filings and notifications performed, HNE management believes that it qualifies for tax exempt status under IRC Section 501(c) (4) and has filed Form 1024, seeking affirmation from the Internal Revenue Service ("IRS"). Because of the lack of authoritative guidance by the IRS regarding treatment of such actions, it is difficult to conclude whether or not HNE would be successful in sustaining their tax-exempt position upon examination by the IRS.

SUMMARY OF RECOMMENDATIONS

IT Review

As noted, KPMG's Information Technology Advisory Services unit was engaged by the Division to evaluate the IT environment of the Company based on guidance provided by the NAIC Financial Condition Examiner's Handbook. Based on this review we noted several existing conditions and opportunities where certain controls could be strengthen and associated risks could be mitigated going forward. Senior management has been made aware of these conditions and the Company has begun to take steps to address these examination concerns.

ACKNOWLEDGEMENT

Acknowledgement is made of the cooperation and courtesies extended by the officers and employees of the Company during the examination.

The assistance rendered by KPMG LLP who participated in this examination hereby is acknowledged.

A handwritten signature in black ink, appearing to read "John M. Curran", is written over a horizontal line.

John M. Curran, CFE
Supervising Examiner and
Examiner-in-Charge,
Commonwealth of Massachusetts
Division of Insurance